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The Daily Market

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21 July 2021

USD-ZAR	14.5648/14.5924	**GBP-ZAR**	19.9902/20.0142
GBP-USD	1.3716/1.377	**AUD-USD**	0.736/0.7361
GOLD	$1799.04	**DJI**	34798,00
EUR-ZAR	17.1928/17.2027	**EUR-USD**	1.1796/1.18
USD-JPY	110.14/110.16	**R 186**	7.46%
BRENT	$71.88	**3m JIBAR**	3,683

EVENTS

13:00	SA	SARB rate announcement	Jul 22	3,50%	3,50%
12:30	US	Chicago Fed activity index	Jun		0,29
12:30	US	Initial jobless claims	Jul 17		360k
14:00	US	Existing home sales	Jun	5,95mn	5,80mn
14:00	EZ	Consumer confidence	Jul A	-2,50	-3,30
14:00	US	Leading Indicators	Jun	0,90%	1,30%

FACTORS ON THE RADAR

ECB

What happened?	>	The ECB will hold its first policy meeting this week following the announcements made recently regarding its policy strategy review
Relevance	>	This meeting will set the tone for the ECB’s monetary policy for the foreseeable future
Importance	>	4/5 (monetary policy)
Analysis	>	No changes are expected to rates but some guidance will be provided on the PEPP programme which could see it extended or expanded from the Sept meeting

Fed's Powell

What happened?	>	Powell's term as Fed Chair is coming to an end but he currently enjoys broad support within the Biden administration
Relevance	>	Powell's renomination will keep the Fed's policy stance consistent
Importance	>	3/5 (Monetary policy)
Analysis	>	Although Powell will be renominated, the Democrats will look to put their stamp on the Fed through appointments at other key positions as posts expire

US Treasury Cash Pile

What happened?	>	The US Treasury needs to reduce its cash pile to $450bn by the end of the month when the debt cap suspension comes to an end
Relevance	>	Return of the debt ceiling is creating some uncertainty in money markets
Importance	>	3/5(fiscal policy/ money markets)
Analysis	>	Reducing cash means lowering bill issuance which will further suppress front end rates and threaten the Fed's control over key benchmark rates

TODAY'S TALKING POINT

SARB Interest Rate Announcement: Jul 22
Expected: 3.50%
Prior: 3.50%

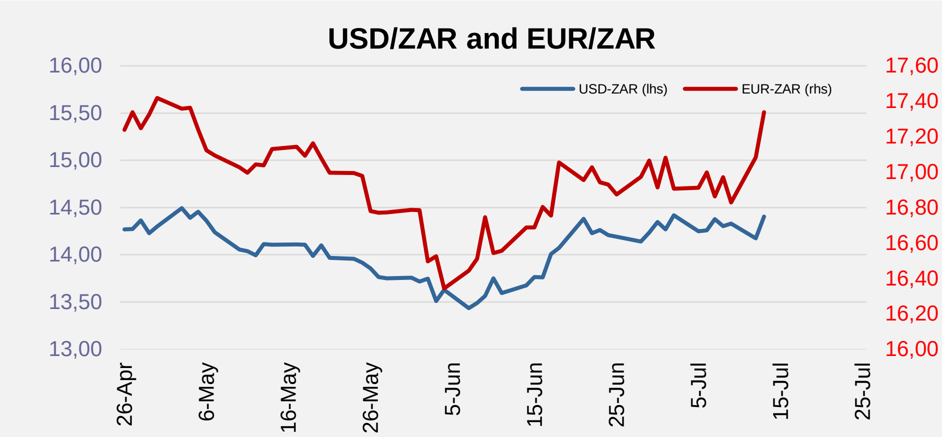
Analysis: Perceptions that SARB would begin tightening monetary policy settings in H2 of 2021 has been vague, particularly with SARB's QPM model providing misleading rate hike expectations. However, since the May meeting, several major developments would suggest that the scales are firmly in favour of the SARB keeping the rate unchanged at 3.50%. This is primarily because of SA's weak economic recovery, brought on by the virus and the reintroduction of restrictions and the slow rollout of vaccines, among various other impediments. SARB will, therefore, assess the balance of risks to inflation as contained, for now. Policymakers will consequently have scope to maintain an ultra-loose monetary policy stance and we don't foresee any rate moves this year as SA's growth outlook was still weak, even before the disruption and destruction of supply chains, retail stores and factories by last week's looting. Going forward, there may be increased pressure on SARB to hike rates early on in 2022, but much will depend on how the ZAR fares through the rest of the year.

RAND UPDATE

After some further intraday weakness at the start of the day, the ZAR managed to pull back and reverse losses against the US dollar as the greenback's rise this week showed signs of easing. As broader market sentiment improves, haven currencies such as the USD and the Japanese Yen will begin to fall out of favour while riskier currencies advance. The ZAR was ultimately able to capitalise on improving risk appetite as it secured its first daily gain this week, appreciating 0.35% to 14.5750/$.

The ZAR's weakness of late has come hand in hand with rising implied volatility levels. Implied volatilities, which measure the cost of hedging rand weakness, have steadily climbed since June, with the rise in shorter-dated contracts outpacing that of longer-dated ones. Specifically, at-the-money volatility for the one-week option is at its highest since March amidst global risk aversion and the upcoming SARB rate announcement, while implied volatilities for longer tenors appeared to steady yesterday. This suggests traders see greater near-term volatility and potential weakness for the currency.

Despite paring losses later in the session yesterday, the ZAR shrugged off a CPI print that showed inflationary pressure moderated in June and will likely continue in the coming months as base effects are filtered out. The headline inflation print fell to 4.9% y/y in June from 5.2% y/y in May. Core CPI, meanwhile, edged marginally higher to 3.2% y/y from 3.1% prior. Despite headline inflation remaining above the SARB's target range midpoint of 4.5%, core CPI increases continue to suggest there has been limited inflation pass-through on broader goods prices.



Today's SARB rate decision will be made in the context of lower growth expectations and higher forecast uncertainty, suggesting that another hold is likely. Moreover, sclerotic business conditions suggest that what the SARB terms "the output gap" widens further in coming quarters while retail demand remains weak. This could see a reduction in overall rates guidance from the growth-sensitive SARB today. The South African presidency highlighted recently that the looting and riots were estimated to have caused around R50bn worth of damage in the first round, while placing 150,000 jobs at risk, just over 2.1% of jobs in Gauteng and Durban, according to Quarterly Employment Survey data. This is more palpable when considering that unemployment rates are already among the highest globally.

While the losses will be offset through SASRIA cover, it should be noted that these losses are more than the coverage. With any act of violence, the more lasting damage will be to investor sentiment. Both wealth and physical emigration rates rise in times of political upheaval, which will ultimately hollow out the productive capacity of SA. All the while, productivity has been on the decline. Businesses will be returned to operation, yet many will be reconsidering their investment mandates. This builds the case for a drop in future investment, perhaps barring some first-round functional reparations where possible, with business owners unlikely to raise risk exposures to politically exposed areas. Savings rates could also be expected to rise in response, reducing second-round inflationary impacts.

This suggests that the SARB's forecasts of expected growth, retail and import demand, and the output gap are likely to be revised lower, while nascent signs suggest that base effect-driven inflation pressures are already abating. This is likely to draw down the outlook for rate normalisation. Particularly with the ZAR still stronger against the dollar y/y, as the SARB did highlight at its last meeting, ZAR weakness could bias inflation pressures upward. Higher import inflation remains an additional risk in the months ahead.